(23)

No. 91-194

In The

Supreme Court of the United States

October Term, 1991

QUILL CORPORATION,

Petitioner,

v.

STATE OF NORTH DAKOTA,
by and through its Tax Commissioner,
HEIDI HEITKAMP,

Respondent.

On Writ Of Certiorari To The
Supreme Court Of The State Of North Dakota

BRIEF FOR RESPONDENT

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QUESTION PRESENTED

Whether, under the commerce clause and the due process clause of the fourteenth amendment, North Dakota may apply its use tax collection statute to a direct marketer that has established minimum contacts with the state by purposefully availing itself of carrying on business within the state.

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STATEMENT OF THE CASE

North Dakota use tax law requires "every retailer maintaining a place of business in this state" to collect use tax from its customers. N.D. Cent. Code § 57-40.2-07 (Supp. 1991). In 1987 the definition of "retailer maintaining a place of business" was amended to include a retailer who regularly or systematically solicits sales in North Dakota through various means of communication. N.D. Cent. Code § 57-40.2-01(7) (Supp. 1991); Pet. App. A47-A48. "Regular or systematic solicitation" is defined

as three or more separate transmittances of advertisements during a specified twelve month period. N.D. Admin. Code § 81-04.1-01-03.1(3); Pet. App. A56-A57.

Petitioner Quill Corporation ("Quill"), one of the nation's largest direct marketers of office supplies and equipment, is incorporated in Delaware, and maintains its principal place of business in Lincolnshire, Illinois, with offices and warehouses in Illinois, California, and Georgia. J.A. 28.

Quill solicits sales through the mailing of catalogs and advertising flyers to customers throughout the United States, including several thousand North Dakota customers. J.A. 29; Brief in Response to Defendant's Motion for Partial Summary Judgment and in Support of Tax Commissioner's Cross-Motion for Summary Judgment, Mar. 18, 1990, ("T.C. Response") Ex. D at 8-9.

Proceedings Below

Respondent State of North Dakota ("North Dakota"), through its State Tax Commissioner ("Tax Commissioner"), notified Quill in 1989 that Quill was statutorily required to obtain a permit and remit use tax on its sales to North Dakota customers. J.A. 6. When Quill failed to comply, North Dakota filed a declaratory judgment action in North Dakota district court asking that Quill be declared a retailer maintaining a place of business in North Dakota. J.A. 5-6. Quill resisted, arguing that N.D. Cent. Code §§ 57-40.2-01(6),(7) and 57-40.2-07, as applied to Quill, violate the due process and commerce clauses of the United States Constitution as interpreted in *National*

Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753 (1967). J.A. 14-17.

Deciding cross-motions for summary judgment, the district court found persuasive the state's arguments that the use tax statute as applied to Quill was constitutional, Pet. App. A40; however, the court concluded that the facts in *Quill* were indistinguishable from the facts in *Bellas Hess* and held that the statute was unconstitutional as applied to Quill. Pet. App. A42. North Dakota appealed to the North Dakota Supreme Court. Notice of Appeal, June 27, 1990; J.A. 2. On review, the North Dakota Supreme Court reversed, concluding that

> Quill's significant economic presence within the State and its retained ownership of property within the State generate a constitutionally sufficient nexus to justify imposition of the purely administrative duty of collecting and remitting the use tax.

Pet. App. A35-A36. Quill then petitioned this Court for review. The Court granted review on the first question presented in Quill's petition (concerning the application of *Bellas Hess* to this case) and denied review on the second question presented (concerning the retroactivity of a holding that Quill is required to collect the use tax). J.A. 52.

Statement of Facts

Quill enjoyed annual gross sales in excess of $200,000,000 nationwide and North Dakota gross sales in excess of $970,000 during the tax periods at issue. T.C. Response, Ex. D at 6-7. Quill's net North Dakota sales

(gross sales less returns) were $925,000 annually, making Quill the sixth largest retailer of office supplies and equipment in North Dakota. *Id.*; J.A. 38-39; J.A. 43. Quill paid neither the North Dakota use tax nor the Illinois sales tax on its North Dakota sales. T.C. Response, Ex. D at 5-6.

Quill sells more than 9,500 different office products ranging from computers to staples. T.C. Response, Ex. D at 6. All of the office products Quill sells to North Dakota consumers are subject to the state's sales or use tax if purchased by anyone other than a person holding an exemption or a resale certificate. *Id.* Quill's principal customers are businesses that purchase Quill's products for their own use. Quill has 3,427 active North Dakota customers, and advertises its products to the North Dakota customers and others by mailing catalogs and flyers, by placing advertising materials in nationally circulated card packs, and by placing magazine advertisements in nationally distributed periodicals and trade journals. T.C. Response, Ex. D at 8, 10, 11-12, 13.

Quill solicits North Dakota businesses with 62 different bulk mailings of its catalogs and flyers annually, sending 230,000 pieces of mail, weighing more than 48,000 pounds, into the state each year. T.C. Response, Ex. D at 9-10. Quill's active customers may receive as many as five different mailings per month. Schwartz, "Quill Bares Its Teeth in Battle with Office Supply Superstores," 30 *Adweek's Marketing Week*, Nov. 27, 1989, at 19. Quill employees also conduct telephone solicitations of its active North Dakota customers. T.C. Response, Ex. D at 11-13 and Ex. I at 2.

Quill maintains a telephone bank of 95 operators in Lincolnshire, Illinois, to receive customer orders. Of the more than 200,000 nationwide orders Quill receives each month, approximately 50% are received by phone, with the remaining orders taken by a combination of mail, fax, telecopy, telex, and computer modem. T.C. Response, Ex. D at 14-15.

Quill service representatives communicate, by telephone, with customers to assist in the selection of custom printing orders and to handle problems with the print orders forwarded to Quill. T.C. Response, Ex. H at 9 and Ex. F at 10-11. Quill maintains a telephone "help line" to assist customers with questions or problems that may arise after the customer receives the merchandise. T.C. Response, Ex. I at 6-7.

Quill has licensed to North Dakota customers a computer software program, Quill Service Link ("QSL"), which allows direct communication between Quill and its customers via computer modem. T.C. Response, Ex. F at 8-9 and Ex. A attached thereto. Quill issues a packet containing two floppy diskettes to the customers who purchase QSL. The customers must insert the diskettes into their own computers to communicate with Quill. T.C. Response, Ex. I at 20-21. Quill retains title to the diskettes and the software program while the diskettes are in the customer's possession. T.C. Response, Ex. F at 8-9 and Ex. A attached thereto. With QSL, a customer may determine inventory availability, check price lists, order merchandise, and communicate with others having access to Quill's computers via an electronic bulletin board. *Id.* Quill can also initiate communications with its customers via QSL. *Id.*

All of Quill's merchandise is sold on the basis that its customers must be "100% satisfied." To back this guarantee, Quill provides free trial periods and a ninety-day period within which the customer may return merchandise to Quill for any reason. T.C. Response, Ex. F at 14-15 and Ex. B attached thereto. Prices in Quill's semiannual catalogs are guaranteed for six months and in its sales flyers for up to two months. T.C. Response, Ex. H at 9 and Ex. 5 attached thereto at 1.

Before December 1989 Quill sold merchandise only upon an open account, accepting only money orders or checks drawn on the customer's bank account. T.C. Response, Ex. D at 20 and Ex. K at 4. In December 1989 Quill began accepting credit cards as payment in all states except North Dakota. T.C. Response, Ex. H at 16-21 and Dep. Ex. 1 attached thereto.

Quill employees conduct credit checks on its customers, telephoning North Dakota customers and North Dakota banks and financial institutions to verify credit information. T.C. Response, Ex. D at 22-23 and Ex. F at 3. Credit checks on certain customers are also performed by Quill employees at the Illinois location by mail, telephone, and telecopy. *Id.*

Quill directly competes with North Dakota office supply and equipment retailers. T.C. Response, Ex. M. Quill employees conduct telephone price surveys of various merchants in order to price Quill's products competitively. *Id.* Potential Quill customers in North Dakota have used Quill's catalogs and flyers to negotiate lower prices from local office supply and equipment retailers. *Id.* These customers then have told North Dakota retailers

that they do not want to pay the North Dakota sales tax because Quill does not charge tax on its sales. T.C. Response, Ex. D at 11-13 and Ex. I at 2.

Direct marketing has been defined by industry experts as "the distribution of goods, services, or information to targeted consumers through response advertising while keeping track of sales, interest, behavior, wants and needs in a relational computer database." Rapp, "The Tower of Babel," 54 *Direct Marketing Magazine* 1, May 1991, at 76. Direct marketers today use a full panoply of communications techniques, including bulk mailings, telephone and fax communications, and computer technology, as well as other telemarketing methods.[1]

The mail order component of direct marketing (referred to by one author as "direct-order-marketing") has been further described as

> all forms of business based on selling goods or services directly to the public without an intermediary, while obtaining orders by means of direct-response advertising in magazines and newspapers, on television or radio, by direct mail or in any other medium and delivering [the product or service] to the customer's address.

Id. It is estimated that between 65% and 75% of all American households now receive mail order catalogs each year. Fishman, *1990 Guide to Mail Order Sales* (Lincolnshire, Illinois: Marketing Logistics, Inc.) 1991, at X-13.

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[1] For in-depth factual treatment of the mail-order industry and the use tax collection issue, see Defendant's Brief in Response to Plaintiff's Cross-Motion for Summary Judgment and Reply Brief, Ex. N.

In 1990 alone 13.7 billion catalogs were mailed; this amounts to a 74% increase since just 1982. Direct Marketing Association, Inc., *DMA Statistical Fact Book 1991-1992* ("DMA Stat. Book") at 88. Quill, by itself, accounts for the mailing of 65,000,000 pieces of mail a year. Schwartz, *supra*, p. 4 at 18-19.

Outbound telemarketing (the solicitation of business by telephone) has grown dramatically in the past decade because of the reduction in the cost of long-distance telephone service. Spending on outbound telemarketing is now estimated at $30,000,000,000 annually. Baier, Hoke, Jr., Stone, "Direct Marketing Flow Chart," 54 *Direct Marketing Magazine* 6, Oct. 1991, at 2.

In the 1990's undoubtedly even more direct marketers will follow Quill's lead in relying on technological advancements in computer software programming, database management, fax machines and telephones to communicate more effectively with customers than by mail.[2] Direct marketing service experts have predicted that in the 1990's direct marketers will receive more orders by fax than by mail, and that more catalogs will be delivered in the format of interactive media, such as

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[2] A database provided by one computer service company costs only $695 and provides information useable by business-to-business direct marketers on 7,000,000 companies, segmenting these companies by geographic area, sales volume and industry type. *See* 54 *Direct Marketing Magazine* 4 (Aug. 1991), at 14. Additionally, the National Center for Database Marketing has even been developed to present conferences on the use of databases for direct marketing. 53 *Direct Marketing Magazine* 10 (Feb. 1991), at 25-26.

television, video disk and on-line computer systems. Haggin and Kartomten, "Predictions for the 1990's," 7 *Catalog Age* 3, Mar. 1990, at 95-96.

Interactive voice response technology will be in widespread use in the near future. This technology permits a customer to place an order by merely pressing a few buttons on a touch-tone telephone. Deloitte and Touche, *A Special Report on the Impact of Technology on Direct Marketing in the 1990s* (New York: Direct Marketing Association, Inc.) 1990, at 45-47. Interactive television, which is currently being developed, provides a direct electronic linkage between the viewer and the broadcaster. Future transmission of interactive television via fiber-optic cable will enable the viewer to request specific product displays on the viewer's television screen at any time and to place purchase orders directly over the same cable that sends the television program. *Id.* at 51.

Based in part upon the technological advancements described above, the direct marketing industry has grown from sales of $2,400,000,000 in the days of *Bellas Hess* to a $130,400,000,000 industry today. *See Bellas Hess*, 386 U.S. at 763; Advisory Commission on Intergovernmental Relations ("ACIR"), *State Taxation of Interstate Mail-Order Sales: Revised Revenue Estimates, 1990-1992*, Dec. 1991, at 3 (report updating the ACIR's two earlier reports, *State and Local Taxation of Interstate Mail Order Sales* (A-105), Apr. 1986, and *Estimated Revenue Potential from State Taxation of Out-of-State Mail Order Sales* (SR-5), Sept. 1987. As a direct result of the shifting of purchases to out-of-state direct marketers, the 1991 uncollected use tax loss from mail order sales is estimated to be $3,080,000,000 with a $3,270,000,000 projected tax loss for 1992. *Id.* at 2.

SUMMARY OF ARGUMENT

In accordance with the fundamental fairness principle that is at the heart of both the due process and commerce clauses, North Dakota may constitutionally impose a use tax collection obligation on Quill, a direct marketer that has established minimum contacts with the state by purposefully availing itself of the substantial privilege of carrying on business within the state.

The essence of Quill's argument is that this Court's 1967 decision in *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967), established a rule that a state may impose a use tax collection obligation only on an out-of-state business that has a physical presence in the state. Pet. Br. at 18. Assuming this is the correct construction of *Bellas Hess*, the underpinnings of that decision have been repudiated by this Court. Further, under current commerce clause and due process jurisprudence, fundamental fairness is served when a multistate business having sufficient minimum contacts with a state pays for the benefits it receives from the state and competes on a level playing field with other businesses.

Bellas Hess is grounded on an interpretation of the commerce clause that prohibited all state taxation of businesses engaged in interstate commerce. This Court rejected that formalistic free trade interpretation of the commerce clause in 1977. In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), the Court, instead, adopted a

test that considers the practical effects of a tax statute on multistate businesses. Under the *Complete Auto* four-prong test, application of a state tax statute to multistate businesses is constitutional when the tax: 1) is applied to an activity with a substantial nexus with the taxing state; 2) is fairly apportioned; 3) does not discriminate against interstate commerce; and 4) is fairly related to the services provided by the state. *Id.* at 279.

The second and third prongs of the *Complete Auto* test state traditional commerce clause principles: A state may only tax its fair share of an interstate transaction (avoiding duplicative taxation), and multistate businesses must be allowed to compete with local business on a fair, nondiscriminatory basis. The commerce clause does not create a nationwide tax-free haven for multistate business. North Dakota's use tax statute comports with these commerce clause principles because it cannot result in duplicative taxation and treats multistate business on the same terms as in-state business.

The remaining prongs of the *Complete Auto* test embody traditional due process concerns of fair play and substantial justice. Applying the due process principles that govern both personal jurisdiction and taxing jurisdiction, a state may impose a tax on a multistate business when that business has sufficient minimum contacts with the state, *International Shoe Co. v. Washington*, 326 U.S. 310 (1945), and there is a fair relation between the tax and the benefits received, *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1940). This due process fairness standard has been articulated more clearly in the taxing context in decisions concluding that authority exists when a marketer has purposefully "avail[ed] itself of the substantial privilege

of carrying on business within the State." *Mobil Oil Corp. v. Commissioner*, 445 U.S. 425, 437 (1980). This functional test, which permits a court to consider a variety of factors in determining nexus, is more fundamentally fair than an arbitrary physical presence test which is dependent upon what may be the mere happenstance of the location of a piece of property.

Quill has regularly and systematically solicited North Dakota's consumer market through its bulk mailings into the state, and telephone, fax, telex, and computer modem connections with its North Dakota customers. It is the sixth largest retailer of office supplies and equipment in North Dakota. Quill has received substantial benefits from the state, including state laws that create the commercial structure within which an orderly marketplace may function. Requiring Quill to pay its own way for these benefits is not only fair to Quill and the state, but also to the local merchants and multistate direct marketing businesses that have physical property in the state.

Quill's administrative cost of complying with the North Dakota use tax statute is simply a cost of doing business and is irrelevant to the constitutional analysis. In addition, computer technology already exists which would allow Quill to comply readily with its use tax collection obligations. Requiring Quill to collect and remit the state's use tax would not be unduly burdensome and would not violate either the due process clause or the commerce clause.

Even under the nexus test Quill promotes, Quill has sufficient contacts in North Dakota to require Quill to comply with its use tax law. These contacts include: 1)

Quill's retention of title to the QSL diskettes and software property that its customers use in North Dakota; 2) Quill's many telephone, telex, fax, and computer modem connections with North Dakota residents; and 3) Quill's delivery into North Dakota of 24 tons of catalogs and advertising flyers that must be processed through North Dakota's waste disposal system.

A decision that Quill must bear the administrative duty of collecting the state's use tax from its North Dakota customers will result in Quill, its multistate and in-state competitors, and the citizens of North Dakota being accorded the fairness the Constitution requires.

ARGUMENT

I. THE PHYSICAL PRESENCE TEST ESPOUSED BY QUILL IS NOT SUPPORTED BY THE CASE LAW AND DOES NOT ACHIEVE THE FAIR RESULT REQUIRED BY THE DUE PROCESS AND COMMERCE CLAUSES.

North Dakota imposes a sales tax on sales of tangible personal property made within the state's boundaries. N.D. Cent. Code ch. 57-39.2 (1983 & Supp. 1991). North Dakota also imposes a use tax on the in-state use of property which was purchased outside of the state and upon which no sales tax was paid. *Id.* ch. 57-40.2. The state sales and use tax rates are identical. *Id.* §§ 57-39.2-02.1, 57-40.2-02.1 (Supp. 1991).

State use taxes are enacted to prevent state residents from avoiding payment of the state sales tax by making purchases outside the state. In addition, use tax laws "put

local retailers subject to the sales tax on a competitive parity with out-of-state retailers exempt from the sales tax." *National Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551, 555 (1977); *see also Boeing Co. v. Omdahl*, 169 N.W.2d 696, 714 (N.D. 1969). This Court has recognized the "impracticability of collecting the state's use tax from the multitude of individual purchasers." *National Geographic*, 430 U.S. at 555. Because of this collection difficulty, states place the burden of collecting use taxes on out-of-state sellers. *See generally* Hartman, *Collection of the Use Tax on Out-of-State Mail-Order Sales*, 39 Vand. L. Rev. 993, 994-95 (1986); McCray, *Commerce Clause Sanctions Against Taxation on Mail Order Sales: A Re-Evaluation*, 17 Urb. Law. 529, 557 (1985).

In 1967 this Court held that state and local governments may not impose a use tax collection duty on an out-of-state mail order firm that communicates with local purchasers in the taxing jurisdiction only by mail or common carrier as part of a general interstate business. *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753 (1967). Quill construes *Bellas Hess* as holding that out-of-state firms must maintain a physical presence in a state to be subject to the state's tax jurisdiction. *See* Pet. Br. at 18.

Bellas Hess, a national mail order firm, argued that the Illinois statutes requiring it to collect use taxes violated the due process clause and created an unconstitutional burden on interstate commerce. The Court found the application of the Illinois statutes to Bellas Hess unconstitutional, but it did not clearly articulate whether its holding was grounded on the commerce clause, the

due process clause, or both. *Bellas Hess*, 386 U.S. at 756, 758-760.

Whatever the doctrinal basis for the *Bellas Hess* decision, the case is distinguishable from the facts here because, unlike Bellas Hess, Quill owned property physically present in the taxing jurisdiction.[3] The more fundamental reason for not applying *Bellas Hess* to this case is that the underpinnings of that decision have been removed by this Court's subsequent decisions and does not comport with current due process and commerce clause jurisprudence. Therefore, the argument that a physical presence in the taxing jurisdiction is required for taxing authority to exist should be rejected.

II. THE *BELLAS HESS* DECISION WAS BASED ON THE FREE TRADE COMMERCE CLAUSE DOCTRINE THAT WAS OVERRULED IN *COMPLETE AUTO*.

Because it is unclear whether the *Bellas Hess* holding was grounded on the due process clause or the commerce clause, both issues will be addressed in this brief. However, due process decisions rendered at the time of the *Bellas Hess* decision and the language of *Bellas Hess* itself indicate that the ruling was based primarily, if not completely, on commerce clause considerations.

At the same time the Court decided *Bellas Hess*, it dismissed for want of substantial federal questions two

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[3] See discussion of Quill's contacts with North Dakota, *infra*, at 29-31, 45-47.

appeals in which state courts, under the due process clause, had found taxing or regulatory nexus where there was no in-state physical presence. The two cases involved pure due process considerations because they concerned the insurance industry, an area over which Congress has removed all commerce clause restrictions. *McCarran-Ferguson Act*, ch. 20, 59 Stat. 33 (1945) (codified as amended at 15 U.S.C. §§ 1011-1015 (1982)). In *Ministers Life & Casualty Union v. Haase*, 30 Wis. 2d 339, 141 N.W.2d 287, *appeal dismissed*, 385 U.S. 205 (1966), the state court upheld state taxation and regulation of an out-of-state insurance company that did business only by mail and national advertisements. In *People v. United Nat'l Life Ins. Co.*, 66 Cal. 2d 577, 427 P.2d 199, 58 Cal. Rptr. 199, *appeal dismissed*, 389 U.S. 330 (1967), the court held that the state could require an out-of-state insurance firm to obtain a certificate of authority to sell insurance by mail. These summary dismissals demonstrate that even at the time *Bellas Hess* was decided, the Court did not require physical presence to establish nexus under the due process clause.

The language of *Bellas Hess* also demonstrates that the decision was premised on a "free trade" interpretation of the commerce clause. The Court wrote:

> [i]f the power of Illinois to impose use tax burdens upon [Bellas Hess] were upheld, the resulting impediments upon *the free conduct* of its interstate business would be neither imaginary nor remote. . . .
>
> The very purpose of the Commerce Clause was to ensure a *national economy free from such unjustifiable local entanglements*. Under the Constitution, this is a domain where Congress alone has the power of regulation and control.

Bellas Hess, 386 U.S. at 759-60 (emphasis added) (footnote omitted). This analysis embodies the very essence of the free trade rule articulated in *Freeman v. Hewitt*, 329 U.S. 249 (1946), and in *Spector Motor Serv., Inc. v. O'Connor*, 340 U.S. 602 (1951), *overruled*, *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). *Freeman* and *Spector* stood for the proposition that "a tax on the 'privilege' of engaging in an activity in the State may not be applied to an activity that is part of interstate commerce. . . . [This] rule reflect[ed] an underlying philosophy that interstate commerce should enjoy a sort of 'free trade' immunity from state taxation." *Complete Auto*, 430 U.S. at 278 (footnote omitted).

The *Bellas Hess* commerce clause analysis, which was based on the free trade, tax immunity approach of *Freeman* and *Spector*, has been soundly rejected by this Court because it did not address "the problems with which the Commerce Clause is concerned." *Id.* at 288. To the extent that *Bellas Hess* has been interpreted to require physical presence for taxing nexus, the fundamental change in the law under *Complete Auto* compels a rejection of that interpretation.

III. THE NORTH DAKOTA USE TAX STATUTE IS CONSTITUTIONAL AS APPLIED TO QUILL BECAUSE IT SATISFIES THE FOUR-PRONG TEST OF *COMPLETE AUTO* AND DUE PROCESS CASE LAW.

The most basic goal of the commerce clause is to ensure that out-of-state businesses are not placed at a

competitive disadvantage and may compete with local businesses on a level playing field. *See Complete Auto*, 430 U.S. at 288 (1977) (quoting *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 254-256 (1938)). Where interstate commerce is accorded equal treatment with local commerce, the challenged state tax will be sustained. *See, e.g., Tyler Pipe Industr., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 243-247 (1987); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 272 (1984); *Maryland v. Louisiana*, 451 U.S. 725, 759 (1981); *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 331 (1977).

It is indeed ironic that Quill relies upon the commerce clause to maintain a tax-free mail order haven. Instead of "employing the Commerce Clause as a shield against unfair, discriminatory practices [that favor] local merchants, Quill . . . raises the Commerce Clause as a sword to carve out a tax-free mail order niche and gain an unfair competitive advantage over local retailers." *North Dakota v. Quill Corp.*, 470 N.W.2d 203, 215 (N.D. 1991) Pet. App. A25.

Quill's theory places multistate businesses not on a level playing field with "Main Street" businesses but in a privileged position and at a competitive advantage. This Court has rejected this result. In *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 623-24 (1981), the Court found:

> The exploitation by foreign corporations . . . of intrastate opportunities under the protection and encouragement of local government offers a basis for taxation as unrestricted as that for domestic corporations. . . . To accept appellants' apparent suggestion that the Commerce Clause prohibits the States from requiring an activity

> connected to interstate commerce to contribute to the general cost of providing governmental services, as distinct from those costs attributable to the taxed activity, would place such commerce in a privileged position. But . . . [i]t was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.

(Citations and internal quotation marks omitted.)

All businesses that have sufficient contacts with a state must pay their own way. Requiring those businesses to collect the state's use tax ensures a level commercial playing field; this is all that North Dakota seeks.

In *Complete Auto* the Court rejected the formalistic *Spector* rule that any direct tax on interstate commerce is unconstitutional *per se* and, instead, adopted a test based on the practical effects of the tax statute in question. *Complete Auto*, 430 U.S. at 279. Under the rule announced in *Complete Auto*, a state tax will survive a commerce clause challenge "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id.*

A. The North Dakota Use Tax Statute Is Fairly Apportioned And Does Not Discriminate Against Interstate Commerce.

The second and third prongs of the *Complete Auto* test address traditional commerce clause concerns, i.e., apportionment and allocation.

"Fair apportionment" of taxes requires that each state tax only its fair share of an interstate transaction; this avoids the risk of multiple taxation. *Goldberg v. Sweet*, 488 U.S. 252, 260-261 (1989). Because the use tax at issue here is assessed on individual sales to individual consumers and is collected by the retailer for each such purchase, the transaction cannot result in duplicative taxation. Additionally, in the unlikely event that a sales or use tax has already been paid on the same item or transaction, North Dakota provides a credit for that amount, thus precluding any actual multiple taxation. N.D. Cent. Code §§ 57-40.2-04(1), 57-40.2-11 (1983 & Supp. 1991).

The North Dakota use tax collection responsibility does not discriminate against interstate commerce by allocating a larger share of the tax burden to out-of-state retailers. The state sales tax rate is the same as the state use tax rate, the collection responsibility is applied uniformly to sales made by in-state retailers and by out-of-state retailers, and the same administrative allowance is provided to both in-state and out-of-state retailers. *See id.* §§ 57-39.2-02.1, 57-39.2-12.1, 57-40.2-02.1 (Supp. 1991), 57-40.2-07.1 (Supp. 1991).

B. *Complete Auto* And The Due Process Clause Require Minimum Contacts With The State And A Fair Relationship Between The Tax Imposed And The In-State Activities.

The first and fourth prongs of the *Complete Auto* test are "a minimal connection between the interstate activities and the taxing State, and a rational relationship

between the income attributed to the State and the intrastate values of the enterprise." *Trinova Corp. v. Michigan Dep't of Treasury*, 111 S. Ct. 818, 828 (1991) (quoting *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425, 436-437 (1980)) (internal quotation marks omitted). The Court has recognized that these two prongs of the *Complete Auto* test embody due process principles. *Id.* ("The *Complete Auto* test, while responsive to Commerce Clause dictates, encompasses as well the[se] Due Process requirement[s]. . . . "); *see also Amerada Hess Corp. v. Director, Div. of Taxation*, 490 U.S. 66, 79 (1989) ("[T]he *Complete Auto* test encompasses due process standards."); I J. Hellerstein, *State Taxation*, § 4.8 (1983). Therefore, the first and fourth prongs of the *Complete Auto* test may be analyzed in conjunction with the due process clause.

The due process nexus requirement is grounded on the principle that a state may not assert authority over an out-of-state entity in a manner that "offend[s] 'traditional notions of fair play and substantial justice.' " *International Shoe*, 326 U.S. at 316. This "fair play" principle assures that "the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state." *J.C. Penney* at 444.[4]

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[4] Although the Court certainly has the power to delineate constitutional standards for state tax statutes, the Court has maintained a long tradition of allowing states to set their own revenue policies:

> Nothing can be less helpful than for courts to go beyond the extremely limited restrictions that the Constitution places upon the states and to inject

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The controlling question here is whether it is fundamentally fair for North Dakota to require Quill to collect the North Dakota use tax. *International Shoe* and *J.C. Penney* established the two elements of the due process taxing jurisdiction standard: 1) minimum contacts (*International Shoe*) and 2) a fair relation between the tax and benefits received (*J.C. Penney*). These two elements both relate to the fundamental fairness of imposing a tax. Fundamental fairness is the essence of the due process clause. *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 477-478, 487 (1985).

Nothing in the policies underlying the requirements of the due process clause suggest that a business, such as Quill, which conducts a regular and systematic retail sales campaign in competition with North Dakota "Main Street" retailers, must be exempt from all state taxation. This is particularly the case when the levy involved is a use tax, for which "[t]he out-of-state seller becomes liable . . . only by failing or refusing to collect the tax from that resident consumer. . . . [T]he sole burden imposed upon the out-of-state seller by [a use tax statute] is the administrative one of collecting it." *National Geographic*, 430 U.S. at 558. It hardly offends traditional due process

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> themselves in a merely negative way into the delicate processes of fiscal policy-making. We must be on guard against imprisoning the taxing power of the states within formulas that are not compelled by the Constitution but merely represent judicial generalizations exceeding the concrete circumstances which they profess to summarize.

J.C. Penney, 311 U.S. at 445.

notions of fair play to make the marketer the tax collector for the State when the taxed activity results from the marketer intentionally projecting its presence into the state. *See General Trading Co. v. State Tax Comm'n of Iowa*, 322 U.S. 335, 338 (1944).

1. Quill Has Minimum Contacts Sufficient To Satisfy The Due Process And Commerce Clause Requirements.

a. The same minimum contacts standard should be applied in tax jurisdiction and personal jurisdiction cases.

The Court held in *International Shoe*, a case involving both personal jurisdiction and taxing jurisdiction, that due process objections to personal jurisdiction and state taxing authority are judged by the same standard: "The activities which establish [the taxpayer's] 'presence' subject it alike to taxation by the state and to suit to recover the tax." *International Shoe*, 326 U.S. at 321. This is hardly surprising, as the "minimum contacts" formula is the touchstone in each setting. *See Burger King*, 471 U.S. at 474 (personal jurisdiction); *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980) (personal jurisdiction); *National Geographic*, 430 U.S. at 561 (taxing authority); *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 345 (1954) (taxing authority).

The Court in *Shaffer v. Carter*, 252 U.S. 37 (1920), recognized that jurisdiction to tax is coextensive with personal jurisdiction. In upholding the imposition of the Oklahoma income tax law to nonresidents with property

or business in the state, the Court held that "[g]overnmental jurisdiction in matters of taxation, as in the exercise of the judicial function, depends upon the power to enforce the mandate of the state by action taken within its borders, either *in personam* or *in rem*." *Id.* at 49.

In addition to these cases, logic compels application of the same minimum contacts standard to personal and taxing jurisdiction questions. There is no qualitative difference between the consequences of a state's exercise of taxing authority and personal jurisdiction which would justify a more stringent test, or closer contacts, in the taxing case. There are potential burdens on out-of-state entities in both instances.

Imposition of a use tax collection responsibility requires collection and remittance of use tax. This is an obligation that is fixed and easy to ascertain. An out-of-state enterprise is only required to collect the statutorily established use tax and remit that amount to the state.

In the personal jurisdiction situation, an out-of-state business may be haled into a state's court and required to defend itself against any number of citizens' claims. The business must incur the cost of litigating a case outside its home state and may encounter the uncertainties of a trial before a court or jury in that "foreign" jurisdiction. In some instances, a state's exercise of personal jurisdiction over an out-of-state business may result (directly or indirectly) in extensive and continuing regulation of that business. For example, a defendant may face the possibility of a large damage award in a products liability case and be required to modify its business practices accordingly. In environmental and other regulatory cases, a state

court exercising long-arm jurisdiction may impose even more direct regulation on an out-of-state business over which it has personal jurisdiction. In other cases that are appropriate for the forum state's exercise of its equitable powers, businesses may be permanently enjoined from or mandated to perform certain duties. *See* Rothfeld, "Mail-Order Sales and State Jurisdiction to Tax," 53 *Tax Notes* 12, Dec. 23, 1991, at 1410-1414.

The performance of an administrative duty, such as use tax collection, is not, as a constitutional matter, so different from other legal duties that a separate jurisdictional test is required. As long as the tax complies with the fair relations test of *J.C. Penney*, notions of fundamental fairness do not require a closer connection to tax than those required for an appearance in court.

b. Physical presence is not a necessary element of nexus for either personal jurisdiction or tax jurisdiction.

In personal jurisdiction cases, the Court has established that physical presence is not necessary for a state to exercise its jurisdiction. The Court held in *Burger King* that

> [j]urisdiction in these circumstances may not be avoided merely because the defendant did not *physically* enter the forum State. Although territorial presence frequently will enhance a potential defendant's affiliation with a State and reinforce the reasonable foreseeability of suit there, it is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire

> communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are "purposefully directed" toward residents of another State, [the Court] ha[s] consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.

Burger King, 471 U.S. at 476 (emphasis in original); *see also Keeton v. Hustler Magazine, Inc.*, 465 U.S. 770 (1984).

This Court has recently articulated how the nexus standard should apply to tax jurisdiction. The Court has held that taxing authority exists when the marketer has purposefully "avail[ed] itself of the substantial privilege of carrying on business within the State," *Mobil Oil Corp. v. Comm'r*, 445 U.S. 425, 437 (1980), or when "the activities performed in [the] state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in the state," *Tyler Pipe Industr., Inc. v. Washington State Dep't. of Revenue*, 483 U.S. 232, 250 (1987). This standard provides a functional test by which taxing nexus should be judged.

While physical presence may be relevant to a nexus inquiry, this Court has not equated nexus and physical presence. In *Miller Bros.*, upon which the *Bellas Hess* Court relied, 386 U.S. at 756-57 n.9, the Court applied a nexus standard that requires a purposeful direction of commercial activities (often shown by regular or systematic solicitations) directed at in-state residents. There the Court held that Maryland lacked jurisdiction to impose a use tax collection responsibility on an out-of-state firm

that, on occasion, sent its own delivery trucks into Maryland because there was "no invasion or exploitation of the consumer market in Maryland." *Miller Bros.*, 347 U.S. at 347.

The due process analysis "cannot be simply mechanical or quantitative," *International Shoe*, 326 U.S. at 319, or "formulary," *J.C. Penney*, 311 U.S. at 445. Although a physical presence test may be simple and absolute in its approach, it is incomplete and falls short of fully addressing economic realities. The ease with which a test may be administered is not determinative of the test's constitutional merit. As the Court recognized in *Complete Auto*,

> [i]t might also be argued that adoption of a rule of absolute immunity for interstate commerce . . . would relieve this Court of difficult judgments that on occasion will have to be made. We believe, however, that administrative convenience, in this instance, is insufficient justification for abandoning the principle that "interstate commerce may be made to pay its way."

Complete Auto, 430 U.S. at 288-289 n.15.

Strict adherence to the concept of physical presence "is, as far as due process is concerned, the most pointless sort of formalism." Rothfeld, *supra*, p. 25 at 1413. Under the "bright line" physical presence test advocated by Quill, if a small multistate business were to sell a machine for $1,000 and hire an in-state contractor to install the machine, nexus would exist. In contrast, there would not be nexus when a multistate business systematically solicited the state's consumer market, sold millions of dollars of machinery, yet avoided maintaining an office, an

employee, a contractor, or a piece of property in the state. Traditional due process notions of fair play and substantial justice are not satisfied by such a result.

The more reasoned approach here is to apply the due process minimum contacts standard provided by this Court in personal jurisdiction cases. This approach will best ensure that the ultimate purpose of the due process clause, fundamental fairness, is satisfied.[5]

It is beyond argument that North Dakota courts could assert personal jurisdiction over Quill if, for example, an in-state purchaser brought suit because he was injured by one of Quill's products. *See Burger King*, 471 U.S. at 473; *World-Wide Volkswagen*, 444 U.S. at 297-298; *McGee v. International Life Ins. Co.*, 355 U.S. 220, 223 (1957); *Hust v. Northern Log, Inc.*, 297 N.W.2d 429, 433 (N.D. 1980). In fact, Quill has never argued in the present case that the North Dakota courts lacked jurisdiction to resolve this dispute.

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[5] The alleged commercial need for a bright line test is satisfied in the present case. By regulation, North Dakota has established a bright line. That is, a North Dakota use tax collection responsibility is invoked in any year Quill mails three or more separate bulk solicitations into the state. N.D. Admin. Code § 81-04.1-01-03.1(3). This bright line is not dependent on the sometimes fortuitous physical presence or "warm body" analysis. Hartman, *supra*, p. 14 at 1014. Rather, Quill has complete control over the events which lead to use tax collection responsibility. Other states have established similar de minimus standards. *See* note 19, *infra*.

c. Quill has purposefully availed itself of the privilege of carrying on business in North Dakota.

Quill concedes that it has regularly and systematically solicited North Dakota's consumer market. Memorandum in Support of Defendant's Motion for Partial Summary Judgment, Dec. 18, 1989, at 10. Quill has purposefully "avail[ed] itself of the substantial privilege of carrying on business" within North Dakota. *Mobil Oil*, 445 U.S. at 437. During the 12-month period at issue, Quill mailed 230,000 pieces of mail, weighing more than 24 tons, to North Dakota residents.[6] Quill sent 62 different bulk mailings into North Dakota in the 12-month period. In contrast, Bellas Hess mailed two catalogs per year into Illinois to its active or recent customers; it also occasionally mailed flyers to both active and potential customers. *Bellas Hess*, 386 U.S. at 754. Quill directly entered the North Dakota market through its regular and systematic mailings to North Dakota consumers. These mailings created tons of garbage, which remain in North Dakota landfills.

Quill is in close communication with its North Dakota customers, providing services traditionally performed only by local merchants. Quill targets its active

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[6] Quill mails into North Dakota each year 230,000 written solicitations in the form of bulk mailing of semiannual catalogs, monthly sales flyers, monthly tabloids, monthly multimailers, bimonthly computer supplies flyers, bimonthly furniture and office machine flyers, imprint products flyers, legal flyers, card packs, and tilling flyers. T.C. Response, Ex. D at 10. On the average Quill made more than one mailing per week to its active North Dakota customers.

customers in North Dakota, on an average basis sending them as many as five mailings per month. Quill maintains a telephone bank of operators to receive customer orders. Approximately 50% of the orders Quill receives are made by phone, with the remaining orders taken by a combination of mail, fax, telephone, telex, and computer modem. Quill maintains a telephone "help line" to assist customers with questions or problems that may arise after the customer receives the merchandise.

Quill's QSL software permits direct communications between Quill and its customers. With QSL, a customer may determine inventory availability, check price lists, order merchandise, and communicate with others having access to Quill's computers via an electronic bulletin board. Quill also can initiate communications with its customers via QSL.[7]

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[7] Quill's high-tech use of computer connections with its customers is representative of similar advancements being used by the direct marketing industry. Two nationwide networks, Prodigy and CompuServe, provide home shopping services via computer modem and now have more than 1.3 million subscribers. Fishman, "Mail Order Top 250," 54 *Direct Marketing Magazine* 3, July 1991, at 41-43. Through their computers Prodigy subscribers can make purchases of goods, services and securities, write checks, conduct other banking transactions and have access to more than 40 companies; more than 100 companies are accessible in CompuServe's "Electronic Mall." *Id.* at 40, 43. These networks are experiencing explosive growth, driven by the rapid penetration of personal computers into American households. Prodigy membership grew 125% in 1990 and CompuServe grew 77%. *Id.* at 40-41. Electronic purchasing transactions on Prodigy quadrupled in 1990. "On-Line Services," 53 *Direct Marketing Magazine* 9, Jan. 1991, at 14. It is

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Quill's activities in the state have resulted in annual untaxed sales of nearly $1,000,000 to North Dakota customers. Through Quill's electronic communication and sophisticated computer marketing and mailing list techniques, Quill has intentionally projected its presence into the state and systematically exploited North Dakota's markets. It would be anomalous to hold that commercial entities may escape all taxation by the states from which they draw substantial benefits simply because they do not have a contractor, employee, traveling salesman, or office location in the state. Quill's almost $1,000,000 in annual sales proves it is present in North Dakota. Requiring Quill to collect the North Dakota use tax comports with fundamental fairness.

2. The North Dakota Use Tax Law Is Fairly Related To Quill's North Dakota Activity.

The fair relation test established in *J.C. Penney* and embodied in the fourth prong of the *Complete Auto* test is

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predicted that there will be increased public acceptance of "video-text services" like Prodigy and CompuServe, thus increasing the shift of the sales tax base from customers of store-bound retailers to those using cable, fiber optic, and satellite communications. Deloitte and Touche, *supra*, p. 9 at 50. Marketers consider video-text users to be a highly desirable market segment. *Id.* CompuServe estimates that the average income of its household subscribers is $86,200. Fishman, "Mail Order Top 250," 54 *Direct Marketing Magazine* 3, July 1991, at 42. Thus, those without access to in-home computers with which to shop will continue to pay sales tax, while those having such access will often be able to avoid, should they desire to do so, the direct payment of any sales or use tax.

satisfied when "the measure of the tax [is] reasonably related to the extent of the contact." *Commonwealth Edison*, 453 U.S. at 626. This Court consistently has rejected assertions that the tax must be fixed or prorated to benefits to be constitutional. Rather, it is enough that a state "runs mass transit and maintains public roads which benefit [the taxpayer's] customers, and supplies a number of other civic services," *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 32 (1988), makes possible " 'the benefit of a trained work force,' " *Commonwealth Edison*, 453 U.S. at 624 (citations omitted), or offers the taxpayer "other advantages of civilized society," *Goldberg*, 488 U.S. at 267. In such cases the tax is adequately "tied to the earnings which the State . . . has made possible, insofar as government is the prerequisite for the fruits of civilization for which, as Mr. Justice Holmes was fond of saying, we pay taxes." *J.C. Penney*, 311 U.S. at 446; *see also Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163, 188-191 (1989).

The Court repeatedly has held that there need not be a dollar-for-dollar correlation between the benefits conferred by the state and the tax imposed on an out-of-state commercial entity:

> [t]he tax which may be imposed on a particular interstate transaction need not be limited to the cost of the services incurred by the State on account of that particular activity. . . . On the contrary, "interstate commerce may be required to contribute to the cost of providing *all* governmental services, including those services from which it arguably receives no direct 'benefit.' "

Goldberg, 488 U.S. at 267 (emphasis in original) (quoting *Commonwealth Edison*, 453 U.S. at 627 n.16).

While it would be impossible to enumerate every way in which North Dakota services benefit Quill, many are readily apparent. State and local governments build and maintain the roads that permit Quill to ship its goods from out-of-state. The state also provides other general services that benefit Quill. North Dakota devotes a major portion of its resources to the education of its citizens, thereby encouraging a prosperous economy for the benefit of all businesses. The state-supported education system contributes to an ordered and civilized society, which benefits direct marketers as well as local businesses. These services alone would be sufficient to invoke the use tax collection duty.

North Dakota and its local governments also provide other services that are more directly related to the success of Quill and other direct marketers. One such benefit is the provision of reliable telephone service, which is regulated by the North Dakota Public Service Commission. *See* N.D. Cent. Code § 49-02-01 (Supp. 1991).

The benefits that direct marketers derive from state regulation of telephone service are closely intertwined with the benefits conferred by state regulation of financial institutions. *See id.* § 6-01-04 (1987). Modern direct marketers depend heavily on credit checks. The credit check system functions well because the state closely regulates banks, other financial institutions, and creditor networks. Quill employees also conduct credit checks on North Dakota customers by telephoning North Dakota financial institutions. Quill uses this information to make

decisions about extending credit before shipping goods to North Dakota. Thus, Quill relies upon and benefits from this assistance.

North Dakota laws protect transactions and support orderliness in the state's marketplace. *See* N.D. Cent. Code chs. 28-01.1 (Products Liability Act), 41-02 (Uniform Commercial Code sales provisions), 51-10 (Unfair Trade Practices Act), 51-12 (prohibits false advertising), 51-13 (Retail Installment Sales Act), 51-14 (regulates revolving charge accounts), 51-15 (concerning consumer fraud and unlawful credit practices), 51-18 (regulates home solicitation sales), § 54-12-17 (creating consumer fraud and antitrust division to protect against fraud). These laws directly benefit Quill's commercial activities within North Dakota.

Also, North Dakota provides and maintains a judicial system for the enforcement of a direct marketer's property and contract rights, as well as for the collection of its debts. While the record does not reflect that Quill used North Dakota's courts to enforce its contracts or other rights, the state judicial system must remain open and available to Quill should it seek judicial recourse. If Quill decides to enforce collection of its delinquent North Dakota accounts, it must do so in the North Dakota courts. *See Spiegel, Inc. v. Federal Trade Comm'n*, 540 F.2d 287 (7th Cir. 1976) (holding it an unfair trade practice for a mail order firm to sue in its own state of commercial domicile and requiring the firm to sue in the court of the customer's residence).

Without state and local garbage disposal services and regulation, Quill could not conduct its business in the same fashion. In Quill's case, approximately 40% of its

catalogs are sent to prospective customers.[8] "1990 Direct Mail Order Roundup," 53 *Direct Marketing Magazine* 9, Jan. 1991, at 12. Most direct marketing mail solicitations are unwanted; nearly one-half are disposed of unopened and unread. *Time*, Nov. 26, 1990, at 54; *see also* Pet. App. at A34 n.14. Common sense dictates, and the North Dakota Supreme Court found, that "[i]t is the mail order seller who derives the most direct benefit from its own mailings, and it therefore is not unreasonable to assume that the seller derives some measure of benefit from the entity that is ultimately responsible for disposing of the veritable mountain of trash created thereby." Pet. App. at A34-A35; *see also D.H. Holmes*, 486 U.S. at 24, 32. Under traditional nexus principles, Quill receives the benefits and protections of North Dakota laws and services through the disposal of its trash in North Dakota.

Absent the role of government, Quill could not effectively penetrate and saturate local markets. It is entirely appropriate and consistent with both the due process and commerce clause to require that direct marketers pay for their fair share of local services. Compliance with the use tax collection duty is a minimal obligation to impose upon a business that reaps such great rewards from the state's marketplace.

Therefore, the North Dakota use tax statute does not violate the commerce clause or the due process clause.[9]

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[8] Quill's activity is close to average for business-to-business direct marketers, 48% of whose mailings are sent to prospects. DMA Stat. Book at 201.

[9] Although Quill and its amici have raised the specter of retroactivity in their briefs, that issue is not before the Court.

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IV. NATIONWIDE APPLICATION OF THE NORTH DAKOTA SUPREME COURT'S RULING WILL NOT CONSTITUTE AN UNCONSTITUTIONAL BURDEN ON INTERSTATE COMMERCE.

A. Administrative Costs Related To Use Tax Compliance Are Constitutionally Allowed.

Under the four-part *Complete Auto* test, the existence of a nondiscriminatory cost associated with the collection of a use tax is irrelevant to the commerce clause inquiry. *See* 430 U.S. at 288-89. As stated in *Complete Auto*,

> the court has rejected the proposition that interstate commerce is immune from state taxation:
>
> > "It is a truism that the mere act of carrying on business in interstate commerce does not exempt a corporation from state taxation. 'It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business.' "

430 U.S. at 288 (quoting *Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 108 (1975)).

Because the North Dakota statute does not require Quill to incur costs which are greater than the administrative costs imposed on its competitors, the commerce

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The Court denied certiorari on that question. Also, because the Commissioner has not attempted to collect use taxes from Quill, the record is silent on the issue. Finally, retroactivity raises a separate and distinct consideration under the due process clause. *See Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). That separate question need not be decided in this case.

clause is satisfied. For a multistate company that chooses to enter several states' markets and has sufficient minimum relevant contacts with those states, the administrative cost of collecting a use tax in those states is a constitutionally permissible cost of choosing to enlarge its marketplace. A holding to the contrary would discriminate against local businesses and direct marketing competitors simply because those entities have physical property in a state.

There is no logical reason for differentiating between multistate direct marketing businesses such as Sears or J.C. Penney and their direct marketing competitors. Sears or J.C Penney must pay the administrative costs of collecting state and local taxes in each state. *See Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359, 364-65 (1941) (holding that costs and inconvenience of use tax collection are a legitimate "price of enjoying the full benefits" of being privileged to do business in-state); *Nelson v. Montgomery Ward*, 312 U.S. 373 (1941).

The decisions holding that nationwide retailers like Sears must collect sales or use taxes on their catalog sales further demonstrate that an administrative burden associated with use tax collection is irrelevant to the commerce clause inquiry. If the existence of such a cost were sufficient to establish a commerce clause violation for direct marketers like Quill, it should also be sufficient for Sears and J.C. Penney. Yet, the Court has held that those retailers must collect those taxes in each jurisdiction in which they do business. *Nelson v. Sears, Roebuck & Co.*, 312 U.S. 359 (1941); *Nelson v. Montgomery Ward*, 312 U.S. 373 (1941).

Further, Quill's argument is premised on the *Spector/Freeman* tax immunity principle that was rejected in *Complete Auto*. *Spector* and *Freeman* were grounded on a "burden" argument not unlike that Quill raises here. In *Freeman*, for example, the Court stated:

> [a] State is . . . precluded from taking any action which may fairly be deemed to have the effect of *impeding* the fair flow of trade between States. It is immaterial that local commerce is subjected to a similar *encumbrance*. . . . A *burden* on interstate commerce is none the lighter and no less objectionable because it is imposed by a State under the taxing power rather than under manifestations of police power in the conventional sense . . . . Moreover, the *burden* on interstate commerce involved in a direct tax upon it is inherently greater, certainly less uncertain in its consequences, than results from the usual police regulations. . . . Because the greater or more threatening *burden* of a direct tax on commerce is coupled with the lesser need to a State of a particular source of revenue, attempts at such taxation have always been more carefully scrutinized. . . .

Freeman, 329 U.S. at 252-253 (emphasis added). As discussed above, the Court has overruled the *Spector/Freeman* rule, concluding that a state tax may impose a burden on businesses engaged in interstate commerce, as long as that tax satisfies the four-pronged test set out in *Complete Auto*.

Acceptance of Quill's argument that the North Dakota use tax is unconstitutional because it is burdensome would return this Court to the discredited *Spector* rule. A multistate business may have more total administrative costs related to use tax collection because it is

present in multiple taxing jurisdictions. However, the business has voluntarily incurred these costs to avail itself of the benefits of a larger market base. This is a cost of "paying its own way" in the states in which it has chosen to exploit the markets.

B. The Cost Of Compliance With The North Dakota Use Tax Law Is Not Burdensome Or Unfair.

Even if Quill's administrative cost in collecting use taxes for multiple jurisdictions were relevant to the constitutional analysis, those administrative costs, when realistically analyzed, are reasonable and do not justify granting Quill immunity from the state use tax collection requirements.

North Dakota has not sought Quill's collection and payment of any local government use tax. The North Dakota Tax Commissioner seeks only the collection of the state use tax. Appellant's N.D.S.Ct. Br. at 35. North Dakota, therefore, respectfully suggests that the Court reserve for an appropriate case the issue of the alleged administrative burden of collecting local government use taxes. However, should the Court reach that issue in this case, there is sufficient information available upon which the Court may conclude that this alleged burden is not constitutionally significant.

The simplest solution to complying with use tax obligations rests on the same technology that has allowed the direct marketing industry to flourish. Computer software companies, such as Vertex, Inc., and AVP Systems, now

offer off-the-shelf tax compliance software.[10] The Vertex and the AVP compliance systems run on mainframes, minicomputers, or IBM-PC compatibles. Both contain complete, regularly updated state and local use tax rate information for every taxing district in the country and cross-reference tax rates by city name and Zip Code. The compliance systems calculate the tax on each transaction by integrating the tax rate information directly into the direct marketer's own computerized billing system. The systems also automatically generate state and local tax returns, on appropriate forms, for each taxing district.[11] *See generally* Westphal, *The Computer's Role in Simplifying Compliance with State and Local Taxation*, 39 Vand. L. Rev. 1097 (1986); *1988 Hearings, infra*, p. 48 at 415, 620-36. They are available at prices ranging from $7,000 to $12,000.

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[10] No such systems existed in 1967. Vertex released its tax rate system in 1975; AVP released its system in 1979. Westphal, *The Computer's Role in Simplifying Compliance with State and Local Taxation*, 39 Vand. L. Rev. 1097, 1103 n.9 (1986); *1988 Hearings, infra*, p. 48 at 415, *reprinting "New Software Package is Designed to Help Dm'ers Deal with Use Tax"*, DM News, Dec. 1, 1987, at 18, 22. *See also* Defendant's Reply Brief, Apr. 30, 1990, Ex. 42, which sets forth a description of various use tax compliance systems; and Amicus Curiae Brief of the States of Connecticut, Tennessee, California, et al, App. D at 45a.

[11] Contrary to the suggestion (Brief of Amicus Curiae Direct Marketing Association ("DMA Br.") at 20) that tracking exemptions will stump the computer programs described here, Vertex notes that it is "in the final development" of such an update to its software. *See* DMA Br. App. 4, Quest. 12. AVP Systems presently offers such a product. *See* AVP Systems, "The Sales Tax Beacon," Insert (Autumn 1991). Of course, to the extent that any particular tax compliance product for direct marketers does not presently exist, it is likely because the demand for it has not existed.

Note, *Collecting the Use Tax on Mail-Order Sales*, 79 Geo. L. J., 535, 552 n.102 (1991).

The direct marketing industry is aware of the capabilities of such computer technology. "The database plays a vital role in direct marketing, from customer acquisition through the creative process, then the customer transaction and fulfillment, and finally analysis." Deloitte & Touche, *supra*, p. 9 at 15. Direct marketers have amassed "significantly more customer data" as storage costs have decreased.[12] *Id.* at 21. Recent improvements in the price and performance of smaller, less expensive machines have changed the way even the smallest companies do business. According to an article in a leading direct marketing publication, now "[a]nyone can afford to be a database marketer and do the same things that

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[12] Since 1967 the cost of computing has fallen exponentially. According to Brookings Institution economist Kenneth Flamm, between 1957 and 1978, the inflation-adjusted price/performance ratio – the amount in real terms that a consumer must spend to do a given computing task – decreased at an average of 28% per year (or 20% non-inflation-adjusted per year). Flamm, *Targeting the Computer* 25 (1987). A recent Bureau of Labor Statistics study indicates that such price declines have continued. *See* Sinclair and Catron, *An Experimental Price Index For the Computer Industry*, Monthly Lab. Rev., Oct. 1990, at 21, Table 2.

As of 1980, computer memory capacity cost 40 times less than it did in 1970. *See* J. Cortada, *Historical Dictionary of Data Processing* 114 (1987). In any event, an 80 megabyte computer system can be purchased today for less than $1500. That amount of memory is more than sufficient to operate the computerized sales and use tax compliance programs currently available.

[American Express] and other database marketers do, and do it without mainframes and at hundreds times less the cost." Stacey, "The Microprocessor Revolution," 53 *Direct Marketing Magazine* 10, Feb. 1991, at 65.[13] The industry has, at times, acknowledged as much. *See 1988 Hearings, infra,* p. 48 at 243 (testimony of William T. End, Executive Vice President of L.L. Bean, Inc.) (conceding that "I think the computer side of this . . . is irrelevant. . . . [A] small company can handle the computer part of it if it is made simple.")[14]

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[13] A DMA-commissioned study indicates that over 50% of small direct marketing companies, those with less than $10 million in annual sales, presently use minicomputers. Deloitte & Touche, *supra,* p. 9 at 14. Forty-six percent of consumer catalog companies use the larger and more powerful mainframe computers. Forty-three percent use a combination of mainframes and "end-user" data processing. DMA Stat. Book at 268. Almost 65% of direct marketing companies use a computerized inventory system to provide customers with immediate information on item availability. *See id.* at 89. A 1989 DMA survey revealed that only 3.9% of direct marketing companies do not control any end-user applications with personal computers. *Id.* at 274.

[14] The DMA Brief is itself an example of the ease with which computerized systems can quickly compile large amounts of use tax information. The brief extensively relies upon Vertex for a wide range of current use tax data. *See* DMA Br. App. 2, 3. If DMA can accumulate use tax information for the purposes of a brief, it can certainly centralize this information and make it available for the benefit of its members' compliance with collection requirements. DMA could, for example, establish an 800 number where members or their customers could call to get amounts of tax calculated by computer. DMA already provides centralized services to its members. *See* DMA Br. at 23 n.29.

In any case, computer technology also enables both Vertex and AVP to provide even the smallest direct marketers with the manual counterpart of the computer software. Nationwide tax rate manuals, updated monthly, are available for a fraction of the cost of a computerized compliance system.

Quill claims that direct marketers could have use tax collection duties in approximately 6,500 state and local jurisdictions.[15] However, a nationwide mail order business would not be required to file 6,500 separate use tax returns per reporting period. A more accurate number of the jurisdictions in which a mail order company may have to file a return (effective July 1, 1992) is 192.[16]

While the maximum potential administrative cost of filing returns in 192 jurisdictions is not to be ignored or unduly minimized, that potential burden is not unmanageable.

The industry's description of the chaos that may result from customer calculation of tax rates fails to take into account the nature of most direct marketing transactions. The increasing use of credit cards by customers for mail-order purchases alleviates the collection costs

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[15] The number of jurisdictions in the United States levying sales and use taxes is variously cited as "approximately 6500 jurisdictions" (Pet. Br. at 36); "45 states (plus the District of Columbia) *and* over 6,100 local governments" (DMA Br. at 16).

[16] *See* DMA Br., App. 3 at 1, setting forth selected responses to questions posed to Vertex, Inc. by the Multistate Tax Commission.

that accompany customers' errors or omissions when payments are made by check or money order.[17]

Finally, a number of states have enacted legislation to lessen whatever collection burdens do exist. Thus, several states exempt small direct marketers from collecting any use tax,[18] provide uniform rates for state and local use tax collection,[19] or include collection allowance provisions.[20]

Direct mail companies with in-state branches have long complied with nationwide use tax requirements. Their experience demonstrates that the rest of the direct marketing industry would be able to comply as well.

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[17] Note, *Collecting the Use Tax on Mail-Order Sales*, 79 Geo. L.J. 535, 552 n.103 (1991). When a customer makes a purchase on credit, the mail order vendor need not rely on the customer's tax calculation but can itself calculate the tax and charge the customer's account. *Id.* Approximately 53% of all catalog purchases are paid by either credit card or house credit. DMA Stat. Book at 81. In addition, a significant number of catalog companies offer a toll-free number for ordering or for customer service, *id.* at 94, and could calculate tax rates over the phone for customers preferring to pay by check.

[18] *See, e.g.*, Fla. Stat. § 212.0596(G) (Supp. 1990); Minn. Stat. Ann. § 297A.21(4)(c) (West Supp. 1991); Mo. Ann. Stat. § 144.605(14)(a) (Vernon Supp. 1991); N.Y. Tax Law § 1101(8)(iv) (McKinney Supp. 1991); Wash. Admin. Code § 458-20-221(2)(c) (1989).

[19] *See, e.g.*, Tenn. Code. Ann. § 67-6-702(f) (1989); Wash. Admin. Code § 458-20-221 (1989).

[20] *See* ACIR, State and Local Taxation of Out-of-State Mail Order Sales (A-105), Apr. 1986, Table 2-6, at 44.

V. QUILL'S ACTIVITIES IN NORTH DAKOTA WERE SUFFICIENT TO SATISFY THE NEXUS REQUIREMENT OF *BELLAS HESS*.

Quill's contacts with North Dakota exceeded in both type and frequency those presented to the Court in *Bellas Hess*. Assuming the Court concludes that taxing nexus must include a physical contact between an out-of-state direct marketer and a state, that standard is met under the facts in this case.

Quill's connections with the state include its QSL software; its use of telephone, modem, fax, and telex communications with North Dakotans; and its contacts with North Dakota financial institutions to conduct credit checks on its customers. The North Dakota Supreme Court properly relied upon these contacts to find sufficient nexus under *Bellas Hess*. *See also Good's Furniture House, Inc. v. Iowa Bd. of Tax Review*, 382 N.W.2d 145 (Iowa), *cert. denied*, 479 U.S. 817 (1986) (approving the imposition of a use tax collection responsibility based upon the out-of-state marketers' use of television advertising followed by merchandise delivery in their own trucks).

Quill owns property that is physically present in North Dakota. Quill licenses its QSL software to North Dakota customers. As part of its license agreement, Quill retains title to the floppy diskettes necessary to operate the QSL program. Those floppy diskettes are sent to and retained by QSL customers, including its North Dakota customers. T.C. Response, Ex. I at 20-21, Ex. F at 8-9 and Ex. A attached thereto.

Under the physical presence test Quill espouses, the existence of one piece of physical property in the state, even one floppy diskette, is sufficient to establish nexus. *See also In re Heftel Broadcasting Honolulu, Inc.*, 57 Hawaii 175, 554 P.2d 242 (1976), *cert. denied*, 429 U.S. 1073 (1977) (holding existence of the presence of a film property and a licensing agreement granting telecast rights sufficient to establish taxing nexus). It is questionable whether such a result comports with fundamental fairness. The state concedes that the existence in North Dakota of a few floppy diskettes to which Quill holds title seems a slender thread upon which to base nexus. However, if one piece of property is not sufficient, then a question arises as to what quantity or quality of physical property within a state is necessary for nexus to exist. If so, the purported "bright line" status of the physical presence test disappears.

Quill's computer modem/telephone line connection with its North Dakota customers presents another type of contact that was not before the Court in *Bellas Hess*. Unlike Bellas Hess, Quill does not conduct its business with North Dakota residents merely through the use of the United States Postal Service and common carriers. Quill maintains a telephone bank of 95 persons for the receipt of orders. It solicits customers by telephone, takes orders by fax, telex, and telephone, and allows its customers to check its inventory and prices and order through computer modem.

These activities within North Dakota may constitute sufficient nexus for taxing purposes. In an analogous case the Court found sufficient nexus to tax a telephone call when the call either originated or terminated in the state

and was billed or paid for from an address within the state. *Goldberg*, 488 U.S. at 252. Quill conducted similar activities in North Dakota.

Quill's contacts with North Dakota were also much more frequent than the contacts in *Bellas Hess*. There Bellas Hess mailed two catalogs per year (and occasional flyers) to its Illinois customers; Quill mailed 62 different bulk mailings to its North Dakota customers during one 12-month period.

Based upon Quill's varied and frequent contacts with North Dakota, the North Dakota Supreme Court properly concluded that, under applicable due process and commerce clause principles, Quill had nexus with North Dakota sufficient to justify imposition of the purely administrative duty of collecting and remitting the state's use tax.[21]

VI. THE CONSTITUTIONAL QUESTION PRESENTED SHOULD BE RESOLVED BY THIS COURT AND NOT DEFERRED TO CONGRESS.

Quill and its amici urge the Court to defer to Congress. They argue that if any taxing nexus test other than the physical presence standard they claim *Bellas Hess*

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[21] The North Dakota Supreme Court has reserved the question as to whether Quill's retention of title and risk of loss to the goods it sent to its North Dakota customers constituted sufficient nexus under the physical presence test under North Dakota's version of the Uniform Commercial Code (N.D. Cent. Code §§ 41-02-43(1)(a) and 41-02-44(1)). *See* Pet.App. A30-A31. See also the Brief Amicus Curiae for State of New Mexico for a discussion of this argument.

established is to be articulated, that standard should be set by Congress and not this Court. *See* Pet. Br. at 46-49; DMA Br. at 4. It is disingenuous for the direct marketing industry to make this assertion when it has argued to Congress that Congress lacks power to pass legislation revising or limiting *Bellas Hess*. *See Interstate Sales Tax Collection Act of 1987 and the Equity in Interstate Competition Act of 1987: Hearings on H.R. 1242, H.R. 1891, and H.R. 3521 before the Subcomm. on Monopolies and Commercial Law of the House Comm. on the Judiciary*, 100th Cong., 2d Sess. 74-79 (1988) ("*1988 Hearings*") (prepared statement of Lucas A. Powe, Jr., on behalf of the Direct Marketing Association and Magazine Publishers Association); *Collection of State Sales and Use Taxes by Out-of-State Vendors, Hearing on S. 639 and S. 1099 before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance and Taxation*, 100th Cong., 1st Sess. 43-44 (1988) (statement of Lucas A. Powe, Jr., on behalf of the National Marketing Association, Inc., contending that *Bellas Hess* was a due process decision and that Congress may not alter the *Bellas Hess* nexus standards).

This assertion also suggests, incorrectly, that this Court does not have jurisdiction to address the constitutional issues raised in this case. For the reasons stated in Quill's petition and North Dakota's response, this Court should resolve the constitutional question presented.

Should this Court articulate, as North Dakota urges, a nexus standard different from that suggested by Quill, direct marketers will undoubtedly seek congressional protection from additional state use tax collection duties. In a similar situation that arose after the Court decided *Northwestern States Portland Cement Co. v. Minnesota*, 358

U.S. 450 (1959), many large interstate businesses feared that the Court would eliminate entirely any restriction on states' ability to tax interstate transactions. These businesses immediately sought protective legislation, and Congress reacted promptly by enacting Pub.L. 86-272, 73 Stat. 555 (1959) (codified as amended at 15 U.S.C. § 381 (1982)), which prohibits states from imposing a tax on a corporation's net income based solely on solicitation of orders in the state.[22] The direct marketers will likely not be deterred by their own reliance on the due process clause in seeking a congressional reversal of a decision here.

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[22] The legislative history of Pub.L. 86-272 establishes that Congress, even by its adoption of that statute, did not intend to restrict the states from imposing their sales and use taxes on interstate sales. *See* Senate floor remarks of Senator Bush and Senator Bennett:

> "Mr. BUSH. I should like to ask the Senator a question. The question deals with the net income tax on income derived within the State, and so forth. The illustration the Senator from Georgia gave is one of a corporation which does a tremendous business in the State and does not pay any tax. Is it not true that this bill does not in any way inhibit a State from imposing sales taxes, for instance, upon goods sold in the State by a corporation from without the State?
>
> "Mr. BENNETT. This bill does not affect in any way the power of a State to impose sales taxes, property taxes, licenses, any form of tax, except a tax on the income of the foreign corporation."

105 Cong. Rec. 16,362 (1959).

CONCLUSION

For the reasons set forth above, North Dakota respectfully requests the Court affirm the judgment below.

Dated December 26, 1991.

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